CONSUMER MORTGAGE COALITION

January 30, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Uniform Definition of "Clear and Conspicuous" Disclosures
Regulation B – Docket No. R-1168
Regulation DD – Docket No. R-1171
Regulation E – Docket No. R-1169
Regulation M – Docket No. R-1170
Regulation Z – Docket No. R-1167

Dear Ms. Johnson:

The Consumer Mortgage Coalition (the "CMC"), a trade group of national residential mortgage lenders and servicers, appreciates the opportunity to submit its views concerning the proposals ("Proposals") of the Board of Governors of the Federal Reserve System ("Board") to implement a uniform requirement to provide "clear and conspicuous" disclosures in the Board's regulations that implement the Consumer Credit Protection Act – Regulation B (Equal Credit Opportunity), Regulation DD (Truth in Savings), Regulation E (Electronic Fund Transfers), Regulation M (Consumer Leasing) and Regulation Z (Truth in Lending).[1]

This letter focuses on the impact of the changes in Regulations B, Z, and E (collectively, the "Regulations") – the rules that directly affect the mortgage industry. We believe that these changes, although well-intentioned, would have a negative impact on consumers and lenders, and, therefore, urge the Board not to adopt them.

We also discuss the proposed changes to the Official Staff Commentary to Regulation Z regarding the right of rescission. This proposal should be clarified to avoid what appears

1 Regulation M, 68 Fed. Reg. 68791 (Dec. 10, 2003); Regulation Z, 68 Fed. Reg. 68786 (Dec. 10, 2003); Regulation E, 68 Fed. Reg. 68788 (Dec. 10, 2003); Regulation Z, 68 Fed. Reg. 68793; Regulation DD, 68 Fed. Reg. 68799 (Dec. 10, 2003).

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to be an unintended interpretation that would allow some consumers to avoid their obligation to repay the outstanding balance of the loan as a condition to rescinding it.

Uniform Definition of "Clear and Conspicuous"

The Board proposes to amend the Regulations to define "clear and conspicuous" as "[1] reasonably understandable and [2] designed to call attention to the nature and significance of the information in the disclosure." The accompanying official staff commentaries to the regulations would be amended to provide detailed instructions as to–

- Style (such as using "short explanatory sentences or bullet lists whenever possible," avoiding multiple negatives, and avoiding jargon); and
- Formatting (such as using 12-point type – typefaces of less than 8 points would be considered likely to violate the "clear and conspicuous" requirement – and using undefined "wide margins").

Although the CMC supports the goals of the Proposals, which we understand to be better consumer understanding and increased consistency among different regulations, we believe that the Proposals would have severe negative effects that would outweigh any possible benefit to consumers or affected industries. Our concerns include the following:

<u>There is little or no evidence that current disclosures are insufficiently "clear and conspicuous."</u>

There is little evidence that problems in consumer comprehension relate to the clarity or conspicuousness of the disclosures. Indeed, the sheer volume of consumer disclosures and legal documents may impede consumer understanding. The proposed expansion of the clear and conspicuous standard will not ultimately improve consumer understanding. To the contrary, the added disclosures required by the Proposals will only add to the already overwhelming volume of documents presented to consumers in financial transactions.

To take one example, Regulation Z requires that Truth in Lending Act ("TILA") closed-end disclosures be presented in a prescribed, easily readable format in which the disclosures that are defined as "material" are segregated from all others. Despite this longstanding requirement to present information in a clear and conspicuous manner, the Board has noted that the TILA disclosures (together with those required by the Real Estate Settlement Procedures Act) are often inadequate to assist consumers in shopping for the best mortgage loan. *See* Board of Governors of the Federal Reserve System and Department of Housing and Urban Development, *Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act* at II-III, VII-IX, 9-11 (July 1998).

Unfortunately, because of the complexity of the underlying concepts that are being disclosed, in many instances it may be impossible to meet the test that the Board proposes for a "clear and conspicuous" disclosure, that it be "reasonably understandable." Many consumers may find disclosures of information such as balance computation methods beyond their comprehension, no matter how much effort is put into using clear formatting and simple language.

The privacy regulations are not a good model for a reasonably understandable disclosure.

The Board and the other agencies charged with implementing the Gramm-Leach-Bliley privacy disclosures recently issued an Advance Notice of Proposed Rulemaking ("ANPR"), in which they seek suggestions as to how the disclosures required by Regulation P might be made more effective. *See* 68 Fed. Reg. 75164 (Dec. 30, 2003). The ANPR acknowledges "broad-based concerns expressed by representatives of financial institutions, consumers, privacy advocates, and Members of Congress" that the existing disclosures have not been effective, despite the extensive "clear and conspicuous" requirements that they contain. *Id.* at 75166. It does not make sense for Regulation P to be used as a model when that rule may soon be extensively altered to make disclosures more comprehensible to consumers.

Several of the regulations may need to be revised for other reasons in the near future; changes in presentation requirements should be made at the same time.

In addition to the problems with using Regulation P as a model, two of the regulations subject to the Proposals may soon need other revisions. Regulation Z may require significant revision if the pending HUD proposal on RESPA is adopted. See 67 Fed. Reg. 49134 (July 29, 2002). Regulation B may be amended to conform to the revisions in Fair Credit Reporting Act disclosure requirements made by the Fair and Accurate Transactions Act of 2003. Even if the Board believes that a new "clear and conspicuous" standard is required, it should delay such a rule until it proposes revised versions of Regulations B and Z.

Typeface and formatting requirements can limit the amount of information made available to consumers.

Because there is only a limited amount of space available to present a message, requiring that some information be presented in a certain type size and with large margins implies that there will be less room for other important information. For example, Regulation Z requires that an advertisement that shows any "trigger term" – including the length of the loan or the amount of any payment - also include other information such as the APR. A creditor that is now showing the details of its loans in small advertisements or in solicitation letters might decide to drop those details if it had to show all the "triggered" information in a larger typeface with wide margins.

Being required to devote more space to mandated disclosures would also limit the amount of other information that could be presented, or at least the amount that could be presented coherently. There is other information that is helpful to consumers but not specifically mandated, such as the maximum loan-to-value ratio available for a loan with a given APR and payment schedule. These additional, voluntary disclosures might have to be dropped.

Mortgage customers already receive a variety of mandated federal and state disclosures, and Congress has recently increased the volume and complexity of those disclosures in the Fair and Accurate Transactions Act of 2003. Paradoxically, the new requirements to use more white space in disclosures – even when there is no evidence that existing "small print" disclosures have caused a problem – could exacerbate this problem of information overload by increasing the volume of materials presented.

<u>The Proposals would require extensive and burdensome changes in forms and procedures.</u>

The Board asserts that consistency among the regulations would facilitate compliance by institutions, but we believe that the opposite would be true if these Proposals were adopted. The Proposals would create new uncertainty about what is necessary to comply. Financial institutions are already complying with existing requirements, and a new standard, particularly the guidance on formatting, would force financial institutions to expend resources on reviewing existing forms and revising them when necessary.

Many CMC members currently devote significant resources to making all of their forms – whether or not government-mandated – comprehensible and user-friendly. The Proposals, in many instances, would require our members to divert resources from these efforts to an often-futile review of existing practices.

<u>The Proposals are likely to generate frivolous litigation.</u>

Finally, a very serious problem in the Proposals is that they would introduce significant ambiguity into areas of law that had been settled for many years. Many of the requirements in the proposed revised Commentaries are subjective or ambiguous, such as the new mandates to provide wide margins and ample line spacing, as well as the provisions relating to prose style. Because compliance with these standards is a question of fact, plaintiffs' lawyers, including class-action attorneys, might be able to avoid dismissal or summary judgment even with a weak case, which would force companies to choose between settling an unjustified lawsuit and exposing themselves to the risk of litigation. Judges who believe that a lender action is unfair or misleading – although not a violation of any particular federal statute -could seize on the new "clear and conspicuous" provisions as a vehicle to turn the consumer credit statutes into general UDAP (unfair and deceptive acts or practices) laws. This has already been a problem under existing law and can only become worse if the Board adopts its proposal. *See, e.g., Pfennig v. Household Credit Services,* 295 F.3d 522, 530, *rehearing and rehearing en banc denied* (6th Cir. 2002), *cert. granted,* 123 S.Ct. 2639, 156 L.Ed.2d 654 (2003) (invalidating the Board's position that an over-the-limit fee is not part of the finance charge in open-end credit, on the grounds that omitting it "contravenes TILA's statutory goal of providing adequate disclosure"). Before enactment of the Truth in Lending Simplification and Reform Act, a vague requirement to make "clear and conspicuous" disclosures generated thousands of lawsuits over essentially stylistic disclosure issues. *See, e.g., Besaw v.* General Finance Corp., 693 F.2d 1032 (4th Cir. 1982); *Pridegon v. Gates Credit Union*, 683 F.2d 182 (7th Cir. 1982); *Fox v. Heilig-Meyers Co.,* 681 F.2d 212 (4th Cir. 1982); *see generally* R. Rohner and F. Miller, *Truth in Lending* 14 n. 32 ("[a]ccording to data supplied annually by the Administrative Office of the U.S. Courts, more than 2,000 [TILA] and consumer fraud cases were filed annually in the federal courts prior to 1981").

The agencies recognized the problem of lack of precision when they issued Regulation P. Although the CMC would have preferred less ambiguous requirements in Regulation P, there is no private right of action for violations of that regulation, and the regulators will, we hope, exercise prosecutorial discretion in pursuing violators. By contrast, the statutes addressed in the Proposals authorize individual and class actions, which can include high punitive damages as well as court-awarded attorneys' fees. Plaintiffs' class-action attorneys will not consider the potential disruptive impact on financial services businesses or on consumers' access to credit and other financial services before filing suit.

Right to Rescind

The Board is proposing revisions to the Commentary provisions that relate to the power of courts to modify the rescission procedures that normally apply when a borrower exercises the right to rescind. TILA and Regulation Z provide that, in general, once the consumer rescinds, the creditor must, within twenty days, repay the finance charges and other fees paid by the borrower and take any action necessary to reflect the termination of the security interest. *See* Section 125(b) of TILA, 15 U.S.C. § 1635(b); 12 C.F.R. §§ 226.15(d) and 226.23(d). Since enactment of the Truth in Lending Simplification and Reform Act, however, Section 125(b) of TILA has provided that "[t]he procedures prescribed by this subsection shall apply except when otherwise ordered by a court." Regulation Z similarly provides that the normal procedures "may be modified by court order." 12 C.F.R. §§ 226.15(d)(4) and 226.23(d)(4).

The proposed Commentary revisions would affect the Commentary on subsection (d) of Sections 226.15 and 226.23 of Regulation Z, which sets out the steps that the consumer and the creditor must take in connection with rescission in open-end and closed-end transactions, respectively. In particular, paragraph (1) of each subsection (d) provides:

> When a consumer rescinds a transaction, the security interest giving rise to the right of rescission becomes void, and the consumer shall not be liable for any amount, including any finance charge.[2]

Paragraph (2) of each subsection states that the creditor must refund any finance or other charges within twenty days of receiving the rescission notice, while paragraph (3) states that, once the creditor has done so, the consumer must tender any property or money received from the creditor.

<u>The Problem</u>

Our concern with the proposed Commentary revision is with the proposed modification to Comment (d)(4)-1 to each subsection, which would be amended as follows:

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2 The text is drawn from 12 C.F.R. § 226.15(d)(1); 12 C.F.R. § 23(d)(1) is substantially identical.

> 1. Modifications. The procedures outlined in ~~paragraphs~~ § 226.15(d) (2) and (3) ~~of this section~~ may be modified by a court ~~order~~. For example, when a consumer is in bankruptcy proceedings and prohibited from returning anything to the creditor, or when the equities dictate, a modification might be made. The consumer's substantive right to rescind under § 226.15(a)(1) and § 226.15(d)(1) is not affected by the procedures referred to in § 226.15(d)(2) and (3), or the modification of those procedures by a court.[3]

We are concerned that the final sentence could be read as stating that a court has no power to condition the effectiveness of rescission on the consumer's repayment of the principal balance of the loan. In other words, this provision could be read to state that the courts have the power to modify the procedures in paragraphs (2) and (3) but not to place conditions to protect the creditor on the voiding of the security interest under paragraph (1).

This interpretation would defeat the purpose of allowing courts to modify the rescission procedures. As the court noted in *Williams v. Homestake Mortgage Co.*, 968 F.2d 1137, 1140 (11th Cir. 1992):

> Though one goal of the statutory rescission process is to place the consumer in a much stronger bargaining position [than under common-law rescission], another goal of § [125](b) is to return the parties most nearly to the position they held prior to entering into the transaction. The addition of the last sentence of § [125](b), stating that "[t]he procedures prescribed by this subsection shall apply except when otherwise ordered by a court," was added [*sic*] by the Truth in Lending Simplification and Reform Act . . ., and is a reflection of this equitable goal.

A common example of the consequences of not allowing a court to alter the normal rescission sequence is the situation in which the consumer has received a discharge in bankruptcy. If a court cannot delay the voiding of the security interest until the consumer tenders the principal amount due on the loan, then a consumer who has received a bankruptcy discharge can acquire clear title without repaying the principal. A discharged debtor is not personally liable on the loan. Therefore, once the security interest becomes void, the creditor has no way of enforcing its right to have the principal balance repaid. As the *Williams* court noted, the purpose of allowing the court to modify the rescission procedures is to avoid this type of unfair result:

> Thus, we hold that a court may impose conditions that run with the voiding of a creditor's security interest upon terms

[3] The text shows proposed revisions to Comment 15(d)(4)-1; the proposed changes to Comment 23(d)(4)-1 are substantially identical.

> that would be equitable and just to the parties in view of all surrounding circumstances.

Id. at 1142. The six other federal courts of appeals that have considered the issue have agreed with *Williams* that a court may require the consumer to repay the loan before invalidating the security interest. *See, e.g., Yamamoto v. Bank of New York*, 329 F.3d 1167 (9th Cir. 2003); *FDIC v. Hughes Dev. Co.*, 938 F.2d 889 (8th Cir. 1991); *Brown v. National Permanent Federal Savings and Loan Association*, 683 F.2d 444 (D.C. Cir. 1982); *Rudisell v. Fifth Third Bank*, 622 F.2d 243 (6th Cir. 1980); *Rachbach v. Cogswell*, 547 F.2d 502 (10th Cir. 1976); *Powers v. Sims & Levin*, 542 F.2d 1216 (4th Cir. 1976).

<u>Recommendation</u>

We do not believe that the Board's intent in proposing the changes in the Commentary is to prevent courts from taking steps to ensure that the consumer in fact returns the outstanding balance of the loan. Rather, the purpose of the amendment, as stated in the preamble to the proposal, is to allow consumers to obtain a court decision that they are entitled to rescind (because of a violation of TILA that extends the rescission period) before they must tender the property or money received:

> [W]here consumers seek rescission and the matter is contested by the creditor, a determination regarding consumers' right to rescind would normally be made before a court determines the amounts owed and establishes the procedures for the parties to tender any money or property.

68 Fed. Reg. at 68795. The Board's goal appears to be to address the situation in *Yamamoto v. Bank of New York*, 329 F.3d 1167 (9th Cir. 2003), in which borrowers in a contested rescission were required to tender the principal amount before the court determined whether they were entitled to rescission. Since the borrowers could not demonstrate that they had clear title, they could not obtain other financing or sell the property.

The narrower problem presented by the *Yamamoto* case could be addressed by –

- Making clear in the Commentary that the "determination regarding the consumer's right to rescind" involves only the *substantive* right to rescind; and

- Explaining specifically in the preamble to the final Commentary that the revised comment is intended to ensure that the court determines whether the consumer has the substantive right to rescind the transaction before it modifies the procedures outlined in (d)(2) and (3), but should not be construed as preventing the court from conditioning the voiding of the security interest upon the consumer tendering to the creditor the money or property the consumer received. This would address the problem raised in the *Yamamoto* case, while allowing courts to protect the creditor's interests at the same time.

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For the reasons stated, we urge the Board not to adopt the Proposals on the definition of "clear and conspicuous" and to clarify its amendments regarding rescission. We appreciate the opportunity to present our views.

Sincerely,

Anne C. Canfield
Executive Director